Before the
Federal Communications Commission
Washington, DC 20554

In the Matter of	)	
	)	
Developing a Unified Intercarrier Compensation Regime	)	CC Docket No. 01-92
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	)	

To: The Commission

REPLY COMMENTS OF SAGE TELECOM, INC.
ON FURTHER NOTICE OF PROPOSED RULEMAKING

Sage Telecom, Inc. ("Sage") presents the following reply comments in response to the Commission's *FNPRM*[1] in this proceeding. Sage, a competitive local exchange carrier ("CLEC") based in Texas, serves nearly one-half million customers in eleven states. Unlike many other CLECs, Sage is strongly focused on *residential* and *rural and suburban* customers. Over 96% of Sage's customers are residential consumers, and over 74% are located outside of urban areas. Sage's service offerings are currently built around SBC's Local Wholesale Complete product, with Sage providing certain signaling functions, an independent voicemail platform, and customer-facing functions such as billing and customer care. Sage hopes to become increasingly reliant on its own facilities over time, but is likely to remain dependent on ILEC wholesale services in many areas. Because of its focus on residential consumers outside of urban areas, Sage's customers tend to be heavy users of dial-up Internet access. Indeed, over 40,000 Sage customers have no access to cable modem service, and thus must rely on dial-up

[1] *Developing a Unified Intercarrier Compensation Regime,* CC Docket No. 01-92, Further Notice of Proposed Rulemaking, 20 FCC Rcd 4685 (2005) *("FNPRM").*

connections for Internet access, and as many as 185,000 Sage customers actually use dial-up access.

The lack of clarity and the inequities in the existing intercarrier compensation mechanisms create significant business challenges for Sage. Sage thus applauds the Commission's commitment to reforming the intercarrier compensation structure. Sage urges the Commission to do so in a way that rationalizes the current structure and eliminates opportunities for arbitrage and abuse. Specifically, Sage urges the Commission to adopt a revised intercarrier compensation mechanism that prevents perverse subsidy flows whereby residential and rural consumers subsidize certain businesses and "specialized" carriers. The Commission also should ensure that the revised funding mechanism for universal service is equitable, non-discriminatory and technology neutral. Sage concurs with commenters arguing that the Commission possesses the requisite authority to make the necessary changes.

I. THE NEW COMPENSATION STRUCTURE MUST PREVENT PERVERSE SUBSIDY FLOWS

In this proceeding, the Commission faces a fundamental question regarding the structure of competitive local telecommunications markets: Will the Commission permit entities to structure their businesses based on regulatory arbitrage opportunities that result in subsidy flows *from* residential and rural customers *to* certain large and urban businesses? Sage urges the Commission not to do so. If the Commission were to adopt a revised structure that calls for terminating compensation, the Commission should ensure that such subsidy flows to certain large and urban businesses do not occur by excluding ISP-bound traffic from the compensation.

By taking as customers solely ISPs, call centers, and other large businesses that generate largely inbound traffic from residential and rural customers, various specialized CLECs are abusing the existing calling party's network pays ("CPNP") system to create a subsidy flow from other carriers' residential and rural subscribers to themselves and to their own large business and urban subscribers. Such subsidization is bad public policy and patently contrary to the principles of the 1996 Act, which generally calls for residential and rural customers to be the *recipients* of intercarrier subsidies.[2] Under the existing structure, however, those specialized carriers have reversed the intended flow of subsidies by selecting as customers only large businesses that receive primarily inbound traffic from residential and rural consumers. Under this model, carriers serving residential and rural customers (such as Sage) are forced to pay terminating compensation to such specialized carriers, while the specialized carriers (those serving large business users) pay little or no reciprocal compensation to the residential carriers (since ISPs and call centers generate little or no outbound traffic). This significant flow of payments from residential and rural carriers to the ISP-focused, typically urban (specialized) carriers results in an inappropriate subsidy flow *from* the residential and rural customers *to* the urban, large business users and to the specialized carriers themselves.

An improper subsidy flow also is created when specialized CLECs with no facilities or customers in a given area and no transport networks deploy "local" numbers as a substitute for toll-free 8YY numbers (often to provide local inbound calling for their own ISP customers). These specialized CLECs then expect the carrier serving the residential subscriber to bear the cost of transporting the call to the specialized CLEC's distant switch.[3] Further, these specialized CLECs often expect to receive reciprocal compensation for such non-local traffic, despite the Commission's previous determinations to the contrary.[4] While some states' numbering policies

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[2] *See generally* 47 U.S.C. § 254.

[3] *See, e.g.,* Qwest comments at 7; USTA comments at 32 (USTA assumes that the originating carrier serving the residential subscriber will be an incumbent LEC, but Sage can attest that this is not always the case).

[4] *Implementation of the Local Competition Provisions in the Telecommunications Act of 1996; Intercarrier Compensation for ISP-Bound Traffic,* Order on Remand and Report and
(continued on next page)

have helped ameliorate this problem, the Commission should ensure that its new rules do not permit this abuse.

In addition to undermining the intended direction of subsidy flows under the 1996 Act, these improper subsidy flows also are contrary to the 1996 Act's goals of increasing competitive options for consumers. By rewarding specialized CLECs that focus solely on large urban businesses and by financially penalizing competitors that focus on residential and rural customers, the current system creates strong incentives for competitors to shun residential customers.

These concerns are not merely theoretical. Because Sage currently builds its service offerings around SBC's Local Wholesale Complete product, Sage operates on a relatively narrow margin, and is the proverbial "canary in the coal mine" for residential competition. Sage finds itself bombarded by unreasonable claims for terminating compensation from ISP-focused (specialized) CLECs. The Commission's *ISP Remand Order*[5] was helpful, but the D.C. Circuit Court's remand, combined with the *Core Order,*[6] once again have emboldened specialized CLECs to assert claims for substantial compensation. If the Commission wishes for competitors to continue to view serving residential customers, particularly those in rural areas that rely on dial-up connections for Internet access, as a viable business, the Commission must make clear, in

Order, 16 FCC Rcd 9151, 9167 (2001), *remanded, WorldCom v. FCC*, 288 F.3d 429 (D.C. Cir. 2002), *cert. denied*, 123 S. Ct. 1927 (2003) *("ISP Remand Order")* (concluding that ISP-bound traffic is outside the scope of section 251(b)(5)). *See also* Verizon comments at App. B, 25-43 (describing why ISP-bound traffic is not subject to reciprocal compensation).

[5] *See ISP Remand Order*

[6] *Petition of Core Communications, Inc., for Forbearance Under 47 U.S.C. § 160(c) from Application of the ISP Remand Order,* WC Docket No. 03-171, Order, 19 FCC Rcd 20179 (2004), *recons and appeals pending.*

the near term, that its regime will not permit these types of subsidy flows that undermine the public interest.

There is significant support in the record for protecting carriers serving residential subscribers (ILECs and CLECs such as Sage) from harm that results from unnatural revenue flows to specialized carriers that aggregate inbound-only traffic, particularly ISP-bound traffic.[7] This must be a fundamental consideration as the Commission formulates the new intercarrier compensation regime. Further, if the Commission concludes that it should maintain a type of intercarrier payment structure that would otherwise permit such subsidization, such as a CPNP regime that traditionally would not treat ISP-bound traffic differently,[8] the Commission must put measures in place to eliminate these inappropriate subsidies. For example, the Commission could establish a "subsidy prevention mechanism" that would ensure that payments from one carrier to another resulting from the use of dial-up Internet access never exceed the excess of the originating carrier's margin achieved from any end user local line that generated dial-up calls.[9]

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[7] *See, e.g.,* Verizon comments at Exhibit B; Qwest comments at 19; CenturyTel comments at 8, 17, 23, 28; Rural Alliance comments at 162; SBC comments at 23; Texas PUC comments at 7.

[8] Sage acknowledges that the *NPRM* expresses a preference for a *unified* regime. *See, e.g., NPRM* at ¶ 3, *passim.*

[9] The subsidy-prevention mechanism would limit the payment from an originating carrier to a specialized carrier (e.g., ISP-serving carrier) to the residual margin achieved from each local line that generated dial-up calls, determined on a line-by-line basis as follows: Originating Carrier's Local Line Rate Charged (-) [Originating Carrier's Cost (+) Taxes (+) Reasonable Rate of Return]. Where an individual line generated dial-up calls to multiple specialized carriers, the residual margin amount would be divided proportionately. The originating carrier's cost could be established using proxy costs, absent a cost showing by the originating carrier. In the case of carriers like Sage, a large portion of the cost is easily established with reference to the wholesale product forming the basis of key components of its service offering. The line-specific calculation, limited to lines that generated dial-up calls, is necessary in order to avoid perverse subsidy flows and to ensure that carriers have an incentive to serve residential customers in all market areas.

Specialized carriers serving customers that generate disproportionate shares of in-bound traffic could recover the remainder of their costs directly from such customers.[10]

In the *FNPRM*, the Commission stated that it "favor[s] an approach that … limits both the need for regulatory intervention and arbitrage concerns."[11] As demonstrated above, a unified CPNP regime will require substantial regulatory intervention to avoid arbitrage concerns, unless the Commission ensures that ISP-bound and other specialized traffic types are properly removed from the compensation structure.

II. THE NEW COMPENSATION SYSTEM MUST ENSURE FAIR COMPENSATION IN SPECIFIC INSTANCES

In restructuring the access regime, the Commission must ensure that originating LECs providing equal access retain the right to collect originating compensation from IXCs that originate calls on their networks.[12] This function is served under the current regime by originating access charges. The Commission must bear in mind that, with respect to a long distance call in an equal access environment, the originating LEC is neither the "originating" nor the "terminating" carrier for purposes of the billing of the call to the end user. Rather, the originating LEC is more akin to a transit provider, providing two other carriers (the calling end user's IXC, which is the originating carrier, and the called party's local carrier, which is the terminating carrier) with the ability to complete the call. The originating local carrier has no retail relationship to the call, and thus must be compensated by the carrier "originating" the call (in this case, the IXC selected by the end user). To provide otherwise would create uneconomic

[10] Such cost-recovery amounts could be billed by the specialized carriers to those customers that cause them to generate the disproportionate shares of in-bound traffic in the form of charges for service or originating access charges, if the current ESP access exemption is terminated in a more unified regime. *See, e.g.,* Frontier-Citizens UTF Plan at 4 n.3.

[11] *FNPRM* at ¶ 33.

incentives for the use of local networks by IXCs, unfairly favoring stand-alone long distance providers and resulting in another significant unnatural arbitrage situation that saps carriers serving residential customers.

To the extent that the Commission adopts a system that relies on terminating charges, the Commission must ensure that the system eliminates opportunities for fraudulent mislabeling of traffic to avoid compensation.[13] Sage agrees with NECA that there is currently an unacceptably high amount of traffic that arrives unlabeled, so the jurisdictional origin cannot be determined, or later is determined to be improperly labeled in order to benefit from the distinctions of the current regime. If the current distinctions, or any other distinctions, are maintained in the new regime, the Commission must ensure that rules and enforcement mechanisms are in place to prevent fraud and abuse.

III. THE NEW SYSTEM MUST INCLUDE AN EQUITABLE AND NON-DISCRIMINATORY MECHANISM FOR FUNDING UNIVERSAL SERVICE

As noted above, Sage agrees that universal service principles must be maintained as the Commission revises the intercarrier compensation system,[14] and that includes appropriate funding of federal universal service support mechanisms. A funding mechanism based on telephone numbers has received significant attention in this proceeding, and Sage believes that an appropriate numbers-based system probably could be devised. The Commission must ensure, however, that the system is "equitable and non-discriminatory," as the statute requires.

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[12] *See, e.g.,* Cox comments at 8-9.

[13] *See, e.g.,* NECA comments at 16; John Staurulakis comments at 17; MACC comments at 2.

[14] *See supra* Section I (arguing that the FCC must eliminate perverse subsidy flows that undermine universal service by forcing residential and rural consumers to subsidize large, urban business users).

Imposing a contribution obligation on each assigned telephone number would result in significant inequities absent a mechanism to accommodate multiple telephone numbers that are assigned for legitimate purposes to a single line since such different, legitimate uses of telephone numbers generate significantly different amounts of marginal revenue. For example, Sage currently has thousands of customers that have multiple numbers assigned to a single residential line. In many such cases, the second or third number is a toll-free number used by the customer in addition to the customer's traditional geographic number.[15] In some cases, however, Sage customers that purchase "personalized ring" services have multiple (up to three) geographic numbers assigned to a single residential line.

Plainly, adding a second (or third) geographic number to a low-revenue residential line is a very different revenue proposition from providing a telephone number to a large business serving multiple internal extensions. The carrier providing the residential customer with additional numbers provided through the use of a single line may obtain little additional revenue from the assignment of the number, while the carrier assigning the number to the large-volume business user may obtain considerable revenue for the number. And innovative features such as "personalized ring" services may quickly be priced out of many consumers' budgets if a per-number contribution equivalent to that applied to the primary telephone number were to be applied to each additional number provided through the same single line. The contribution methodology must take these important factors into account in order to avoid adverse competitive and consumer impacts.

[15] The existing toll-free system works by "pointing" calls from a given toll-free number to a specific geographic number. Thus, all carriers assigning toll-free numbers also assign the customer a geographic number.

In addition, the contribution methodology must be non-discriminatory and technology neutral. Emerging technologies such as voice-over-Internet-protocol ("VoIP") increasingly are competing with traditional local service providers. Providers that compete with USF contributors also should contribute to USF.[16]

IV. THE COMMISSION POSSESSES THE AUTHORITY TO MAKE THE NECESSARY CHANGES TO THE INTERCARRIER COMPENSATION REGIME

Several commenters in this proceeding have presented cogent arguments laying out the Commission's authority to take the action necessary to rationalize intercarrier compensation payments, including the elimination of inappropriate subsidies.[17] Sage concurs that, at minimum, the Commission possesses the authority to ensure that regulatory arbitrage opportunities do not result in inappropriate subsidies from residential customers and the carriers serving them to large business users, such as ISPs, and the specialized carriers that serve them.

[16] *See, e.g.,* CenturyTel comments at 6.

[17] *See, e.g.,* Verizon comments at App. B. *See also* ICF comments at 38-44; Qwest comments at 22-32.

CONCLUSION

Whatever new intercarrier compensation regime the Commission adopts, it must ensure that the revised system eliminates the current structures that create perverse economic incentives for competitive local carriers to abandon residential and rural customers in favor of ISPs and other large business users that generate largely inbound traffic. Any revised mechanism for funding universal service must be equitable and non-discriminatory, and must take account of the varying revenue potential of different legitimate uses of numbers. Sage believes the comments demonstrate that the Commission possesses the authority, at minimum, to support these actions.

Respectfully submitted,

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